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FACING THE FISCAL CLIFF

A briefing for Delawareans on the economic choices ahead

U.S. SENATOR CHRIS COONS

Over the coming months, Congress will confront what some have called the “fiscal cliff” — more than $500 billion in automatic spending cuts, tax increases and other fiscal changes, all scheduled to take place at the beginning of next year. Depending on the choices made, some of the impacts of these decisions could be felt right away, while others will be spread out over the next 10 years. Though a more apt description might be a “fiscal slope” rather than a “fiscal cliff,” it doesn’t change the fact that serious economic decisions will be made in the weeks and months ahead, and how we handle these choices will have real impact on our nation’s debt, deficits and economy.

As it stands, our budget deficit and national debt are unsustainable. Last year, we ran a budget deficit of $1.3 trillion and we now have a national debt of $16.3 trillion. Members of both political parties agree that excessive debt hurts our competitiveness and causes interest rates to rise over the long term, and crowds out critical investments in our country’s future. Like any budget, when we’re in the red, we have to consider both the amount we are spending and the amount of revenue we are bringing in if we are to get those numbers back in balance.

According to the non-partisan Congressional Budget Office, on the revenue side, federal tax rates are at their lowest levels in more than 30 years. On the spending side, an aging population will cause health care costs through Medicare and Medicaid to steadily rise. At the same time, we continue to spend more on our national defense than the next 13 countries combined. A balanced solution that includes both reducing spending and raising revenue is the most responsible path toward bringing down our dangerous debt and deficit in a way that reflects America’s values.

Although I’ve worked on deficit reduction consistently during my two years in the Senate, my staff and I have invested additional time and energy these last few months preparing for the immediate economic choices required by the events of the fiscal cliff. Just as we do with our legislative briefing emails, I wanted you to have access to some of the same background and analysis that I do.

This white paper walks through the facts of these looming economic events and analyzes their impact on Delawareans. A number of factors will determine how I’ll vote on each of these elements, but I think it’s important to understand that there are no easy answers here: only an array of tough choices. I am eager to hear what you think about each of these decisions, and promise to give your opinions careful thought before I cast my votes.

Chris Coons
U.S. Senator for Delaware

WHAT IS THE FISCAL CLIFF?

The "fiscal cliff" is actually not a single event, but is comprised of four separate economic events with staggered deadlines. Those four events are:

- Expiration of what are known as the "Bush tax cuts"
- Deep, across-the-board federal spending cuts imposed by the "sequester"
- Expiration of a number of temporary tax credits and other revenue measures
- Hitting the "debt ceiling"

If Congress takes no action, all of these events are expected to impact our economy in the first few months of 2013, and the combined effect could be significant. Economists have warned that if all of these events occur at the same time, our gross domestic product could drop, endangering our economic recovery.

For example, if all of the tax provisions, including the Bush tax cuts as well as other tax measures that are part of the fiscal cliff, are allowed to expire, the median Delaware household will see its federal taxes go up by $2,399 in 2013. Additionally, the impacts of the sequester cuts will be felt by many Delawareans over the coming years.

What if all of the tax provisions of the fiscal cliff hit your tax bill?

The median Delaware household would see an average tax increase of $2,399.

Income Level	Avg. Change
Less than $10k	$217
$10k to $20k	$537
$20k to $30k	$1,064
$30k to $40k	$1,417
$40k to $50k	$1,729
$50k to $75k	$2,399
$75k to $100k	$3,688
$100k to $200k	$6,662

NO EASY ANSWERS

Although averting the fiscal cliff seems like an easy choice, the reality is that our country will need to make an array of tough decisions about our competing priorities over the next few months – priorities like keeping taxes low, investing in critical services, reducing our unsustainable annual deficits, and stabilizing our debt.

Tax cuts now will mean more debt later, whereas tax increases now could slow down our economic recovery. Spending cuts now could mean decreased services and slower economic growth, but maintaining current spending levels is economically unsustainable over the long term.

The best solution to our long-term economic challenges is a big, balanced, bipartisan deal that combines tough spending cuts with reforms to our tax code that bring in more revenue while increasing fairness to taxpayers. It is time to get serious about responsibly reducing our deficits and stabilizing our debt, but we cannot balance the budget on the backs of our seniors or the middle class.

In Delaware, we know how to work together across party lines and get things done. Now is the time for Washington to do the same and come together on a big, balanced, bipartisan deal to ensure our continued economic recovery.

1. EXPIRATION OF THE BUSH TAX CUTS

One of the legacies of the presidency of George W. Bush is a series of temporary tax cuts passed by Congress in 2001 and 2003. The cuts caused income tax and estate tax rates to come down steadily until 2010, and Congress extended those rates for 2011 and 2012 to ease the economic burden on Americans during the recession.

Always intended to be a temporary measure designed to stimulate a sluggish economy, the tax cuts have proved to be very expensive. According to the non-partisan Congressional Research Service, the cuts increased the national debt by $1.75 trillion over their first ten years.

More than a quarter of the total value of the Bush tax cuts went to the top 1 percent of income-earners, and two-thirds went to the top 20 percent. Only 16.5 percent of tax savings went to the bottom 60 percent of American taxpayers.

Without Congressional action, these tax cuts will expire for all Americans on December 31st. Congress is now considering whether to let them expire or to extend them for some or all Americans. The non-partisan Congressional Budget Office has estimated that extending all of these tax cuts for another ten years would cost $2.84 trillion, plus another $505 billion in additional interest payments, or "debt service."

For the median Delaware household, returning income tax rates to where they were before the Bush tax cuts would result in a tax increase of about $1,000 in 2013.

The Bush tax cuts not only include temporary reductions in income tax rates, but also include several tax measures targeted at specific kinds of income, including taxes on capital gains and dividends and the estate tax.

What impact would the expiration of the "Bush tax cuts" have on your tax bill?

The median Delaware household would see an average tax increase of $1,056.

Income Level	Avg. Change
Less than $10k	$3
$10k to $20k	$84
$20k to $30k	$460
$30k to $40k	$666
$40k to $50k	$770
$50k to $75k	$1,056
$75k to $100k	$1,476
$100k to $200k	$3,023

Tax rates on capital gains and dividends relate to income or profits from investments, including stocks. If the Bush tax cuts expire, these tax rates would rise. For long-term capital gains, the tax rate would increase from 15% to 20% while dividends would revert to ordinary income tax rates, with a maximum rate of 39.6%.

The estate tax, which is the tax families pay on inheritances, is currently set at a maximum rate of 35%, with $5 million in value exempted. Without Congressional action, the estate tax will increase to a top rate of 55%, with $1 million exempted.

2. TEMPORARY TAX CREDITS AND OTHER MEASURES

A number of other important tax credits are also scheduled to expire at the end of the year, as they do most years. Among other things, these credits prevent unfair tax burdens on Delaware families and help Delaware businesses to innovate and grow. They generally fall into six categories: individual (12 provisions), business (25 provisions), charitable (6 provisions), energy (21 provisions), community assistance (5 provisions), and disaster relief (8 provisions).

One tax measure that requires Congressional action is the Alternative Minimum Tax (AMT). Passed in 1969, the AMT was designed to keep wealthy taxpayers from using loopholes to avoid paying taxes. However, because it's not automatically updated to account for inflation, each year, Congress must "patch" the AMT to prevent middle class taxpayers – to whom the AMT was never intended to apply – from getting hit with an additional tax burden. If Congress doesn't patch the AMT this year, approximately 28 million households will see a tax increase, at an average cost of about $2,800.

What impact would the expiration of the payroll tax cut have on your tax bill?

The median Delaware household would see an average tax increase of $813.

Income Level	Avg. Change
Less than $10k	$68
$10k to $20k	$153
$20k to $30k	$294
$30k to $40k	$442
$40k to $50k	$574
$50k to $75k	$813
$75k to $100k	$1,194
$100k to $200k	$1,763

Another important decision to be made before January 1, 2013 is the future of the payroll tax cut. Enacted in 2011 and extended in 2012 to help middle class Americans deal with the effects of the recession, it reduced employee share of Social Security payroll taxes from just over 6 percent to just over 4 percent. If the payroll tax cut is allowed to expire, taxes for middle class Americans would go up by an average of $1,000 next year, but extending the payroll tax cut would cost more than $110 billion a year.

Action is also required to ensure doctors who take care of our seniors will continue to be reimbursed fairly through the Medicare program and that hard-working Delawareans who lose their jobs through no fault of their own are able to access unemployment insurance.

3. THE SEQUESTER

The failure of the so-called "super committee" to reach a deficit reduction deal left in place dramatic spending cuts known as the "sequester," which are set to automatically take effect in January 2013. The $109 billion in annual across-the-board spending cuts that make up the sequester were designed as a blunt instrument that would force Congress to negotiate in earnest and take action to reduce the deficit and stabilize the debt. Republicans and Democrats in Congress voted to create the sequester assuming that the dire cuts to defense and discretionary programs contained within it would get lawmakers to negotiate in good faith.

Unfortunately, Congress has still not agreed to a deficit reduction deal, and now the sequester looms. The sequester threatens significant cuts to our military and critical domestic spending on everything from education to public safety and vital safety-net programs like heating assistance.

The sequester calls for $54.7 billion in defense cuts per year for nine years, from what are known as "Function 050 funds," which pay for military operations, personnel, procurement and research and development.

The $54.7 billion in annual non-defense cuts will come from both mandatory (entitlement) and discretionary (non-entitlement) programs. The mandatory cuts would include:

- Cuts in Medicare payments to providers and insurance plans. These cuts are limited to 2 percent of such payments in any year, or $11 billion in 2013. This means Medicare providers will continue to bill Medicare in the normal way but will be reimbursed at a rate of 98 cents on the dollar.
- About $5.2 billion in cuts to the other mandatory programs that are subject to sequestration, the biggest of which supports farm prices. Other affected programs include student loans, vocational rehabilitation, mineral leasing payments, the Social Services Block Grant, and dozens of smaller programs.

Thus, in 2013, about $16.2 billion of the $54.7 billion in non-defense cuts will come from mandatory programs. This represents a roughly 8% cut for these programs.

A number of key mandatory programs are exempt from sequestration, including Social Security, Medicaid, the Children's Health Insurance Program, the Supplemental Nutrition Assistance Program (formerly known as the Food

Stamp Program), child nutrition, Supplemental Security Income, refundable tax credits such as the Child Tax Credit and the Earned Income Tax Credit, veterans' compensation and other benefits, and federal retirement.

The remaining non-defense cuts — about $38.5 billion in 2013 — will come from discretionary programs. For fiscal year 2013, the non-defense cuts would occur through an 8 percent across-the-board cut.

If Congress takes no action to prevent the sequester from being implemented, the cuts begin to take effect on January 1, 2013.

4. THE DEBT CEILING

Because our nation is running a deficit, the Treasury needs to borrow money to meet our spending obligations. The amount the United States can owe is legally capped, and in early 2013, we will hit that "debt ceiling."

Right now, that ceiling is $16.394 trillion, and we are likely to bump up against it as early as February.

The last time our nation approached the debt ceiling was in August 2011, when some in Congress said it would be better to default on the sovereign debt of the United States of America than to raise the debt ceiling. The impacts of default would have been severe, but even after it was raised, credit ratings agency Standard and Poor's downgraded the United States' credit rating because of how Congress handled the default crisis.

No one actively wants our country to take on more debt, but the implications of defaulting on the United States' debt are extraordinary and dangerous. Economists tell us that the painful shockwaves caused by default on our debt would compound the potential impacts of the other elements of the fiscal cliff and stall our nation's economic recovery.

If Congress does not pass legislation to raise the debt ceiling soon, we risk our nation being brought to the brink of default for the second time in two years. It is dangerous and irresponsible, and must be prevented.

MOVING FORWARD

Congress should get a big, bipartisan deal to avert the very significant impacts of the fiscal cliff and reduce our deficit done now, and shouldn't wait until next year. It seems like an easy choice to simply avert the cliff and kick the can down the road again, but the reality is that our country will need to make an array of tough decisions about our competing economic priorities over the next few months – priorities like keeping taxes low, investing in critical services, reducing our unsustainable annual deficits, and stabilizing our debt. There is just no easy way out of this situation.

A balanced, bipartisan plan is the only way to responsibly reduce the deficit. We can't tax our way out of this problem, but we can't only cut our way out, either. Balance is the only responsible solution.

ADDITIONAL RESOURCES

FROM SENATOR COONS:

Floor speech on deficit reduction
http://1.usa.gov/MIlFW6

Op-ed on tax plans
http://1.usa.gov/Uf5iUd

Statement on business leaders and fiscal cliff
http://1.usa.gov/S9FmL6

Interview on CNN to discuss tax cuts and fiscal cliff
http://youtube.com/watch?v=1ZgyqffTaow

FROM OTHER SOURCES:

Congressional Budget Office chart on fiscal cliff consequences
http://1.usa.gov/Pxp3Gr

Tax Policy Center's Tax Topics briefing
http://bit.ly/SATVEu

Bipartisan Policy Center fiscal cliff primer
https://bipartisanpolicy.org/fiscalcliff

Wall Street Journal explains the fiscal cliff
http://on.wsj.com/T9JlVo

COMMENTS OR QUESTIONS

If you have comments or questions for Senator Coons, please don't hesitate to contact us. Our Wilmington office can be reached at 573-6345 and our Dover office at 736-5601. You can also send Chris an email by visiting www.coons.senate.gov/contact.